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In the Supreme Court of the United States

OCTOBER TERM, 1974

UNITED HOUSING FOUNDATION, INC., ET AL.,
PETITIONERS

v.

MILTON FORMAN, ET AL.

THE STATE OF NEW YORK AND THE NEW YORK STATE HOUSING FINANCE AGENCY, PETITIONERS

v.

MILTON FORMAN, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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QUESTION PRESENTED

The Commission will discuss the first question presented: Whether shares of common stock in a cooperative housing corporation, offered and sold for more than $32,000,000 to more than 15,000 purchasers, constitute "securities" within the meaning of the federal securities laws.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Commission is primarily responsible for the administration and enforcement of the federal securities laws, including the Securities Act of 1933 and the Securities Exchange Act of 1934. The construction of the term "security" in these acts necessarily determines their applicability in Commission enforcement actions. Private actions by victims of securities laws violations provide a "necessary supplement" to the Commission's enforcement activities. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 382; *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432.[1] The construction of the term "security" also affects the availability of these private remedies.

The Commission opposes restrictive constructions of the securities laws and of the Commission's rules that would weaken the protections they afford investors and narrowly restrict the range of circumstances to which they apply. The Commission has a strong interest in establishing that the instrument involved in the present case—which is represented to be "stock", which evidences an interest in a corporate enterprise over which investors have no direct control, and which is sold upon the promise of significant economic benefits—is a "security" as defined in the federal securities laws.

[1] This Court has noted that "[i]t is now established that a private right of action is implied under § 10(b)" of the Securities Exchange Act, 15 U.S.C. 78j(b). *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n. 9. Also see *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128.

STATEMENT

Certain shareholders of Riverbay Corporation, a limited profit housing company organized under the New York Private Housing Finance Law,[2] brought this action for damages on behalf of themselves, all other Riverbay shareholders, and derivatively on behalf of the corporation, based upon alleged violations of antifraud provisions of the federal securities laws in connection with the offer and sale to them of Riverbay stock.[3] They sought relief against United Housing Foundation, Inc., which initiated and sponsored the project; Community Services, Inc., a profit-making subsidiary of United Housing, which was the sales agent for Riverbay and was the general contractor for the project; certain officers and directors of these corporations; and the State of New York and the New York State Housing Finance Agency (A. 9, 10).[4]

Riverbay shareholders have invested an aggregate of $32,803,200 in the project. They received certificates denominated as Riverbay "stock" (170a).

[2] N.Y. Private Housing Finance Law §§ 2(14–a), 10 and 12(2) (McKinney 1962 ed., Supp. 1974). Article II of that law essentially provides for the creation of "limited-profit housing companies" (§ 13).

[3] The antifraud provisions alleged to have been violated are Section 17(a) of the Securities Act of 1933, as amended, 15 U.S.C. 77q(a). Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b–5 promulgated thereunder, 17 C.F.R. 240.10b–5.

[4] "A." refers to the appendix filed with petitioners' brief in No. 74–157; "P.A." and "P.B." refer to the appendix filed with the petition for certiorari in No. 74–157; "a" preceded by page number refers to the appendix before the court of appeals; "Br." refers to the brief of petitioners United Housing Foundation, Inc., *et al.*

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By virtue of their stock ownership, Riverbay shareholders are entitled to occupy apartment units in a vast cooperative housing project that Riverbay owns and operates (P.A. 5). The project houses approximately 45,000 residents in some 15,400 apartment units (P.A. 3).

Shareholders are also entitled to dividends from any surplus corporate earnings, to be distributed in the form of a reduction in the carrying charges of the apartment units (P.A. 16; 162a), as well as tax deductions for their pro rata share of the real estate taxes and mortgage interest payments made by the corporation (P.A. 17; 175a), and they obtain substantial savings on the cost of housing (P.A. 17).[5]

The complaint charged that Riverbay Corporation sales literature, in the form of an "Information Bulletin" given to prospective buyers, was false and misleading in that it represented that the monthly carrying charge per room would be $23.02, while the charge has in fact been $42.47; that the project would cost $283,695,550, of which $250,900,000 would be financed with a mortgage provided by the New York State Housing Financing Agency when, in fact, the

[5] The N.Y. Private Housing Finance Law provides that a limited profit housing company, subject to state or local supervision, is entitled to borrow up to 95 percent of the cost of a housing project at low interest from the state or a municipality (§§ 22, 27–31). Tax exemptions are provided (§ 33) as is the right of condemnation by a municipality (§ 29). The stock of the company is held by the tenants (§ 12(2–b)), whose probable income may not exceed six times the carrying charges they are obligated to pay each year (§ 31(2)(a)). These charges represent a proportionate allocation of the expenses of the company, including maintenance, taxes, and mortgage indebtedness.

Agency and agents of the corporation had agreed that the project would cost over $400,000,000, financed through a $375,755,710 mortgage loan; and that any increase in construction cost would be absorbed by the contractor, when in fact all increases have been passed on to the shareholders (A. 12–22; 172a).

The district court granted petitioners' motion to dismiss the complaint, holding that respondents' shares in Riverbay were not "securities" within the meaning of the federal securities laws (P.B. 28). The court of appeals reversed, holding that Riverbay stock is a "security," and remanded for further proceedings (P.A. 20, 22).

SUMMARY OF ARGUMENT

One of the important indicia that Riverbay stock is a security within the meaning of the securities acts is its formal denomination as "stock," a word that carries a well-settled meaning (*Securities and Exchange Commission* v. *C. M. Joiner Leasing Corporation,* 320 U.S. 344, 351), and its representation to the public as an "investment" opportunity. Investors may reasonably assume, therefore, that they are purchasing a security.

Another of the indicia is the fact that an investor's money is entrusted to the management of an enterprise over which he exercises no managerial control. The success of Riverbay, and the preservation of the value of capital invested by 15,372 low income investors, depends upon the skill and efforts of the Riverbay management. Riverbay's directors, elected by the shareholders, possess the powers of directors of conventional business corporations.

In addition, significant economic inducements are held out to investors, in the form of promises that stock in Riverbay will entitle them to low-cost housing, tax savings, and dividends from surplus earnings in the form of reduced carrying charges. These economic inducements are sufficient to bring the offering within the ambit of the securities acts, notwithstanding that they are only indirect monetary gains or that investors in fact occupy the housing to which their stock entitles them.

The fact that Riverbay is under the general supervision of the State of New York Housing Agency does not remove it from the federal securities laws. Indeed, those laws contemplated concurrent regulation. Application of the securities acts to limited profit cooperative housing is not inconsistent with other federal regulatory schemes, intended only to govern non-investment aspects of such transactions.

Finally, application of the federal securities laws will not impede the public housing industry or seriously interfere with commercial cooperative ventures. Offers of shares in a cooperative housing enterprise are likely to come within one of several categories of securities exempted from the registration requirements of the federal acts. While these exemptions would not apply to the antifraud provisions, compliance with the antifraud provisions should strengthen rather than weaken the industry by helping to assure that low income persons who invest their limited savings in cooperative housing enterprises are provided with truthful and complete information concerning

the kind of obligations they may incur and the benefits they may reasonably expect to receive.

ARGUMENT

I

RIVERBAY STOCK IS A SECURITY

A. THE SHARES ISSUED BY RIVERBAY CORPORATION ARE SECURITIES BECAUSE THEY ARE STOCK

Section 3(a)(10) of the Securities Exchange Act of 1934 (as amended, 15 U.S.C. 78c(a)(10)) defines a "security" as "any * * * stock, * * * investment contract, * * * or, in general, any instrument commonly known as a 'security.'" A virtually identical definition appears in Section 2(1) of the Securities Act of 1933 (as amended, 15 U.S.C. 77b (1)). See *Tcherepnin* v. *Knight*, 389 U.S. 332.

In determining whether Riverbay stock is a security, it is important that it is offered to the public as "stock." As this Court has noted, with "stocks, * * * the name alone carries well-settled meaning" and documents are included within the definition "if *on their face* they answer to the name or description." *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corporation*, 320 U.S. 344, 351 (emphasis supplied).[6]

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[6] *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, upon which petitioners United Housing (hereinafter designated as "petitioners") rely, does not stand for the proposition that offerings literally deemed "stock" are not "securities" under the securities acts. In *Kern* this Court determined that an exchange of securities in the aftermath of the merger in question was not a "sale" within the language of Section 16(b) of the Securities Exchange Act because the transactions at issue were not susceptible

Consequently, it is necessary to do no more than "merely accept * * * the words of the Act" (320 U.S. at 355). Proof "that documents being sold [are] securities under the Act" may "be done by proving [that] the document itself, * * * on its face * * * [is] stock" (*ibid.*). Petitioners cite no case in this or any other court in which shares in a corporate enterprise, which have been offered to investors as "stock," have been held not to be securities under the federal securities laws.[7]

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of the speculative abuse that 16(b) was designed to prevent. Unlike the instant case, where the offering, denominated "stock", thereby came within the literal definition of "security" in the acts, the exchange of securities in *Kern* was not denominated a "sale" within the literal language of 16(b).

Petitioners also rely on the fact that several courts of appeals have held that certain "notes" are not securities under the federal securities laws, although "any note" is defined to be a security. Yet Congress has specifically excluded certain short-term commercial notes from the definition of "security" in Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c (a)(10). Accordingly, while a distinction exists between notes of an investment character and notes of a commercial character, decisions which ignore the line that Congress itself has drawn between the notes it intended to subject to securities regulation and those it intended to exclude are anomalous. In any vent, notes are of a more variable character than "stock." While notes may arise out of a "current transaction" that does not involve any investment element (see Section 3(a)(3) of the Securities Act, 15 U.S.C. 77c(a)(3)), the same cannot be said of "stock," which inevitably reflects an investment relationship.

[7] The only decision of this Court to which petitioners refer, in suggesting that the plain meaning of the acts should be ignored (Br. 20–21), *Tcherepnin* v. *Knight*, 389 U.S. 332, found a "security" to exist on several alternative grounds, including a literal application of the definitional terms "certificate of interest or participation in any profit-sharing agreement" and "transferable share." See 389 U.S. at 339–340.

Furthermore, "[i]n the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be." *Joiner, supra,* 320 U.S. at 353. Investors who are encouraged to "invest" in what are alleged to be "stocks" may reasonably assume that they are purchasing a security. Here, as in *Joiner, supra,* "other language in the advertising literature emphasized the character of the purchase as an investment and as a participation in an interprise." *Id.* at 346. Petitioners' Information Bulletin expressly "invite[d] offers for shares of [Riverbay's] capital stock" (178a, 196a). Petitioners' sales literature repeatedly emphasized the "investment" or "equity investment" nature of the offering, the "shares" of "stock" being made available, and the corporate form of the enterprise in which shareholders hold voting rights. (See, *e.g.*, 162a, 170–171a.)[8]

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[8] New York law expressly provides that the offer of a share in a cooperative housing corporation is the offer of a "security" subject to New York Blue Sky laws (N.Y. Gen. Bus. Law §§ 352–359 (McKinney 1968 ed., Supp. 1974)). The Blue Sky laws were specifically amended in 1966 to require that the stock of cooperatives formed pursuant to New York State's Private Housing Finance Law, such as that offered by Riverbay, be registered with the State Attorney General (N.Y. Gen. Bus. Law 352-e.)

While the status of Riverbay stock as a "security" under the law of the state of its incorporation and where it conducts its business does not determine its status under the federal securities laws, the treatment of an interest as a security under state law is relevant to a determination of its character under federal law. See *Securities and Exchange Commission* v. *United Benefit Life Insurance Company*, 387 U.S. 202, 211–212. Moreover, the legislative history of the federal securities laws suggests that Con-

Finally, as explained in the next section, the policy underlying the federal securities laws confirms that for the purpose of those laws Riverbay's "stock" should be treated as what it purports to be—a security.

B. ECONOMIC REALITY INDICATES THAT THE SHAREHOLDERS' INVESTMENT IN RIVERBAY IS A SECURITY—THEY HAVE ENTRUSTED THEIR CAPITAL TO THE MANAGEMENT OF OTHERS AS A RESULT OF ECONOMIC INDUCEMENTS

As this Court has repeatedly stated, the federal securities laws, which were "enacted for the purpose of avoiding frauds," must be construed "not technically, and restrictively, but flexibly to effectuate [their]

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gress intended that there be a substantial relationship between the coverage of the federal regulatory scheme and the state regulation of securities. Congress at least intended that securities as defined by state law also be deemed securities under federal law. See H. Rep. No. 85, 73d Cong., 1st Sess. 10, 27–28. S. Rep. No. 47, 73d Cong., 1st Sess. 2, 4; Hearings before the House Committee on Interstate and Foreign Commerce, on H.R. 4314, 73d Cong., 1st Sess. 29. Cf., *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U.S. 293, 298.

In view of the status of Riverbay's stock as a security under New York law, the case for applying the federal securities laws is stronger than in prior decisions of this Court in which the offerings were deemed to be securities even though under state law their status as securities was, at best, doubtful. In *Joiner*, *supra*, the defendants were able to assert, quite reasonably, that under applicable state law the interests sold were essentially real estate. 320 U.S. at 352. In *Securities and Exchange Commission* v. *W. J. Howey Co.*, 151 F. 2d 714, 715 (C.A. 5), reversed, 328 U.S. 293, the defendants also had asserted that only real estate was involved. And "the contract" held to be a security in *Securities and Exchange Commission* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65, "was one of insurance under state law." *Securities and Exchange Commission* v. *United Benefit Life Insurance Company*, 387 U.S. 202, 210.

remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U.S. 180, 195; *Tcherepnin* v. *Knight*, 389 U.S. 332, 336. In using the term "security" in the securities acts, "Congress did not intend to adopt a narrow or restrictive concept * * *." *Tcherepnin* v. *Knight*, *supra*, 389 U.S. at 338. Rather, the term was meant to embody a "flexible * * * principle, * * * capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits."[9] *Securities and Exchange Commission* v. *W. J. Howey*, 328 U.S. 293, 299.

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[9] The legislative history of the Securities Act and the Securities Exchange Act fully supports this broad approach. The ultimate objective of the Securities Act, as the House Committee on Interstate and Foreign Commerce observed, was that "persons * * * who sponsor the investment of other people's money should be held up to the high standards of trusteeship" (H. Rep. No. 85, 73d Cong., 1st Sess. 2, 3.) Similarly, the Senate Committee on Banking and Currency noted that the purpose of the law was to inform the investor "of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation" (S. Rep. No. 47, 73d Cong., 1st Sess. 1).

In enacting the Securities Exchange Act of 1934, 15 U.S.C. 78a, *et seq.*, Congress recognized that "[s]peculation, manipulation, * * * investors' ignorance and disregard of trust relationships by those whom the law should regard as fiduciaries" were "all a single seamless web" (H. Rep. No. 1383, 73d Cong., 2d Sess. 2, 6), and that the Securities Exchange Act's remedial provisions would have to be equal to the problem. "No one of these evils can be isolated for cure of itself alone" (*id.* at 6). The House Committee appraised the function of the Securities Exchange Act as an undertaking to advance the law by a "constant extension of the legal conception of a fiduciary relationship—a

Accordingly, "in searching for the meaning and scope of the word 'security' * * *, the emphasis should be on economic reality." *Tcherepnin* v. *Knight, supra,* 389 U.S. at 336. And "[t]he basic economic reality of a security transaction" is "the subjection of the investor's money to the risk of an enterprise over which he exercises no managerial control * * *." *Securities and Exchange Commission* v. *Glenn W. Turner Enterprises, Inc.,* 348 F. Supp. 766, 773 (D. Ore.), affirmed, 474 F. 2d 476 (C.A. 9), certiorari denied, 414 U.S. 821.

Thus, in *Joiner, supra,* leases of land were held to be securities because leaseholders had purchased them in the expectation that their money would be used to finance the drilling of an oil well on adjacent acreage over which investors had no control. Similarly, in *Howey, supra,* deeds to parcels of land in a citrus grove were held to be securities because "[t]he investors provide[d] the capital and share[d] in the earnings and profits [of the citrus grove]; the promoters manage[d], control[led] and operate[d] the enterprise." 328 U.S. at 300. And in *Variable Annuity, supra,* 359 U.S. at 71, insurance annuity contracts were held to be securities because they "place[d] all the investment risks on the annuitant, none on the [insurance] company" that managed the annuitants' investments and determined investment policy.

In the instant case, Riverbay stock represents an investment in a corporate enterprise over which

guarantee of 'straight shooting'". *Id.* at 5. Thus, the Securities Exchange Act "necessarily covers a wide field." *Id.* at 6.

investors exercise no direct control. Petitioners solicited and obtained $32,803,200 from 15,372 investors who together purchased 1,312,128 shares of Riverbay common stock. These funds were then devoted to Riverbay's limited profit cooperative housing development. The success of the venture is dependent upon the skill and efforts of the Riverbay management.

The Riverbay Corporation, through which petitioners operate, has the same powers as conventional business corporations. It can execute contracts, sue and be sued, acquire real and personal property, and sell, assign, or mortgage its properties.[10] The corporation may engage in certain commercial income-producing activities, such as the leasing of "any of the lands, buildings, structures or facilities embraced" within its property and the "invest[ing of] any funds held in reserves or sinking funds, or any funds not required for immediate disbursement in property or securities in which savings banks may legally invest funds subject to their control."[11] Pursuant to New York's Private Housing Finance Law, any surplus income is to be distributed in a cumulative dividend of six percent on outstanding stock, which may have the effect of reducing the monthly carrying charges that shareholders are obliged to pay in connection with the occupancy of their apartments.[12]

The operation of the corporation is under the control of a board of directors, elected by the shareholders (171a). The corporation can be voluntarily

[10] N.Y. Private Housing Finance Law § 17 (a), (j), and (b).
[11] N.Y. Private Housing Finance Law § 17 (c) and (i).
[12] N.Y. Private Housing Finance Law § 28(2).

dissolved after a certain number of years if all obligations have been paid, in which case "title to the project may be conveyed in fee to the owner or owners of its capital stock."[13] Investors bear the risk that the corporation may go bankrupt,[14] or that its management may, through poor administration, impair the value of their investments. On the other hand, any surplus income is to be distributed to the shareholders in the form of a rent rebate (162a). The surplus income may derive in part from the leasing of retail establishments, office space, parking and other commercial enterprises on the premises (P.A. 16).

In addition, significant economic inducements were held out to the purchasers of Riverbay shares. Here, thousands of low income persons, many apparently relying on fixed incomes,[15] were induced to invest their funds in Riverbay stock by promises that they would thereby enjoy at least three sorts of economic benefit: (a) they would obtain decent housing at a low price, as a result of a low-interest state-financed mortgage and a local real property tax exemption, thereby saving the difference between the cost of the cooperative housing to which their stock entitled them and the average cost of comparable housing;[16] (b) they would

[13] N.Y. Private Housing Finance Law § 35.

[14] As the court of appeals reasoned in this case, "if the corporation [Riverbay] went bankrupt, the shareholders would have sustained a loss in the amount of their investment" (P.A. 18).

[15] Preference at Riverbay is required to be given to the aged, the handicapped and veterans. N.Y. Private Housing Finance Law § 31 (7) and (8).

[16] The Information Bulletin stressed that among the "Advantages of Cooperative Housing" is that "it is a way to obtain decent housing at a reasonable price" (166a).

save taxes by being able to deduct their pro rata share of interest and real estate taxes paid by Riverbay:[17] and (c) their carrying charges for housing would be reduced by any surplus in Riverbay's yearly income (including income derived from commercial tenants).[18]

Contrary to petitioners' contention that "profit" in some narrow accounting sense is required, an investment contract type of security may exist where investors are motivated by any significant economic inducement. The lure of reductions in taxes and costs—such as those that were promised the investors in the instant case—may be as strong an inducement to invest as the hope of direct monetary gain, and one as likely to mislead an innocent investor. It is immaterial whether the economic inducement is in the form of cash payments or, as here, reduced carrying charges

[17] The Information Bulletin also stated:

"Tax Benefits * * * The present laws and regulations entitle tenant-stockholders of cooperative housing corporations to deduct from their gross income for Federal and New York State income tax purposes their proportionate share of real estate taxes and interest paid by such cooperative corporations. The actual tax saving to an individual would depend upon the respective taxpayer's income tax bracket" (175a).

[18] The Information Bulletin also stated:

"If there should be a surplus of income over expenses at the end of the year, the Board of Directors, after providing for adequate reserves, may return this surplus, or part of it, to the cooperators in the form of a rent rebate" (162a).

As the court of appeals noted, the surplus income may derive in part from "the leasing of retail establishments, office space, parking and other commercial enterprises on the premises" (P.A. 16). Retail stores allegedly pay approximately $1,106,000 in rent to Riverbay; an additional $667,000 is derived annually from the rental of office space and coin operated washing machines; and $2.5 million is derived from parking fees paid by tenants and others (P.A. 16).

and tax advantages.[19] "The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." *Howey, supra,* 328 U.S. at 301.[20]

Nor does the fact that investors directly enjoy the housing to which their stock entitles them diminish the investment character of the transaction. In applying the securities acts, "the courts have not been guided by the nature of the assets back of a particular document or offering." *Joiner, supra,* 320 U.S. at 352. If the offering otherwise constitutes a security, "it is imma-

[19] "A saving of expense which would otherwise necessarily be incurred is also a profit to the person benefited. If [a medical services corporation] renders to its * * * members * * * a service at a cost lower than that which would otherwise be paid for such service, the * * * operations result in a profit to its members." *State ex rel. Troy* v. *Lumbermen's Clinic*, 186 Wash. 384, 394–395, 58 P. 2d 812, 816 (Sup. Ct.). Tax sheltered investments have been deemed "securities" (*El Khadem* v. *Equity Securities Corporation*, 494 F. 2d 1224 (C.A. 9), certiorari denied, October 21, 1974, No. 74–46), as have promises of employment (*Davenport* v. *United States*, 260 F. 2d 591 (C.A. 9), certiorari denied, 359 U.S. 909).

[20] Thus, *Howey* cannot be read to require a literal monetary "profit" as one indicia of an investment contract. "The admitted salutary purposes of the Acts can only be safeguarded by a functional approach to the *Howey* test." *Securities and Exchange Commission* v. *Koscot Interplanetary, Inc.*, 497 F. 2d 473, 480 (C.A. 5); see also *Securities and Exchange Commission* v. *Glenn W. Turner Enterprises, Inc.*, 474 F. 2d 476, 482 (C.A. 9), certiorari denied, 414 U.S. 821; *Lino* v. *City Investing Co.*, 487 F. 2d 689, 692–693 (C.A. 3); *Miller* v. *Central Chinchilla Group, Inc.*, 494 F. 2d 414, 416–417 (C.A. 8); *Silver Hills Country Club* v. *Sobieski*, 55 Cal. 2d 811, 361 P. 2d 906 (Sup. Ct.); *State Commissioner of Securities* v. *Hawaii Market Center, Inc.*, 52 Ha. 642, 485 P. 2d 105, 108 (Sup. Ct.).

terial * * * whether there is a sale of property with or without intrinsic value." *Howey, supra,* 328 U.S. at 301. Thus this Court has held that interests in real estate constitute "securities" where their value depends in part on the seller's undertaking to drill an oil well on contiguous land (*Joiner, supra*), or to cultivate, harvest and market a citrus crop thereon (*Howey, supra*).

This Court has also recognized that, although a contract taken as a whole might appear to involve something quite different from a security, the "entirely distinct promises * * * included in the contract * * *" must be independently assessed. On that basis, the Court held that a "separable portion of the contract" might be found to be a security as defined in the federal securities laws. *Securities and Exchange Commission* v. *United Benefit Life Insurance Company,* 387 U.S. 202, 206–209.

II

APPLICATION OF THE FEDERAL SECURITIES LAWS TO STOCK ISSUED BY STATE-SPONSORED HOUSING COOPERATIVES IS NOT BARRED BY OTHER STATE OR FEDERAL REGULATORY SCHEMES

Contrary to petitioners' contentions, the fact that Riverbay is under the general supervision of the State of New York through its Housing Agency does not remove it from the federal securities laws, nor is the federal interest in protecting investors from allegedly fraudulent misrepresentations in the sale of Riverbay

stock inconsistent with effective state regulation of the limited profit housing industry.[21]

While in certain limited cases the availability of an exemption from the registration requirements of the Securities Act or Securities Exchange Act may turn upon whether the particular organization offering securities is supervised and examined by state or federal authorities,[22] such securities are not thereby exempt from the federal securities laws. Indeed, the securities acts were intended in part to overcome the ineffectiveness of state regulation.[23] "Concurrent regulation * * * was contemplated by the Acts as a quite generally prevailing matter. Nor is it rational to assume that Congress thought that *any* business whatsoever regulated by a specific class of officials * * * would be for that reason so perfectly conducted and regulated that all the protections of the Federal Acts

[21] See *Securities and Exchange Commission* v. *National Securities*, 393 U.S. 453, 463 ("The paramount federal interest in protecting shareholders is * * * perfectly compatible with the paramount state interest in protecting [insurance] policyholders").

[22] See, Section 3(a)(5) of the Securities Act, 15 U.S.C. 77c (a)(5), and Section 12(g)(2)(C) of the Securities Exchange Act, 15 U.S.C. 78*l*(g)(2)(C).

[23] In enacting the Securities Act, Congress specifically decided not to exempt state-regulated securities from federal jurisdiction, stating:

"The exemptions do not include the securities of public utilities and others more or less supervised by the respective State blue sky commissions. * * * State laws have failed to meet the present situation in the sale of utility and other securities in interstate commerce, with resultant loss to our people of billions of dollars" (S. Rep. No. 47, 73d Cong., 1st Sess. 4).

would be unnecessary," *Securities and Exchange Commission* v. *Variable Annuity Life Insurance Company, supra*, 359 U.S. at 75 (Brennan, J., concurring, emphasis in the original).

Application of the antifraud provisions of the federal securities acts to the investment aspects of limited profit cooperative housing is not inconsistent with other federal regulatory schemes that may govern non-investment aspects of the same transaction. The Interstate Land Sales Full Disclosure Act, as amended, 15 U.S.C. 1701–1720, cited by petitioners, was intended to govern the interstate sale or lease of certain underdeveloped land, as distinct from investment aspects of land sales to which the securities laws apply.[24] See, *e.g.*, *Howey, supra; Joiner, supra.* The Real Estate Settlement Procedures Act of 1974, Pub. L. 93–533, 88 Stat. 1724–1731, was intended to aid individuals in closing federally-related mortgage transactions, rather than to protect them from fraudulent misrepresentations in the sale of stock. And Section 821 of the Housing and Community Development Act of 1974, Pub. L. 93–383, 88 Stat. 740, also cited

[24] At the time the Act was under consideration, the Commission expressly disclaimed expertise in transactions solely involving the sale of land. In testifying before the Senate Subcommittee on Securities of the Committee on Banking and Currency, the Commission's then Chairman, Manuel F. Cohen, distinguished packaged investment interests coupled with land sales (to which the securities acts apply) as, for example, the citrus growing scheme involved in *Securities and Exchange Commission* v. *W. J. Howey Co.*, from pure real estate sales. Chairman Cohen also noted that the Commission had had some experience in real estate matters arising from so-called real

by petitioners, did not "add to or change in any way laws affecting * * * cooperative construction, sales, or ownership." [25]

III

APPLICATION OF THE FEDERAL SECURITIES LAWS WILL NOT IMPEDE THE PUBLIC HOUSING INDUSTRY NOR SERIOUSLY INTERFERE WITH COMMERCIAL COOPERATIVE VENTURES

Contrary to petitioners' contentions, there is no reason to assume that application of the federal securities laws will impede the housing industry nor seriously interfere with commercial cooperative ventures.

The registration requirements of the securities acts, while hardly burdensome,[26] are generally inapplicable to petitioners' type of operation. Section 3(a)(11) of the Securities Act, 15 U.S.C. 77c(a)(11), exempts from that Act's registration requirements securities offered and sold solely to residents of the state where the issuer is incorporated or resident and doing business. This exemption would frequently be available for state-sponsored housing developments, since such developments are intended primarily, if not exclusively, for the benefit of the state's own citizens. In-

estate investment trusts and other entities of that character. The Chairman pointed out that several other agencies, including the Bureau of Land Management in the Department of the Interior and the Housing and Home Finance Agency in the Department of Housing and Urban Development, were far more experienced than the Commission in dealing with the real estate market and in the valuation of land and subdivisions. (Hearings before a Subcommittee of the Senate Committee on Banking and Currency, on S. 2672, 89th Cong., 2d Sess. 84, 89–91.)

[25] Statement of Rep. Rosenthal, who introduced the legislation, 120 Cong. Rec. H5371 (daily ed., June 20, 1974).

[26] Even should no exemption be available from the registration and prospectus requirements, the costs of registration would not have a material impact upon the costs of the project

deed, in the case at bar, the sales literature reflects that the offer was being extended only to residents of the State of New York (170a). Moreover, any security issued or guaranteed by any state or political subdivision thereof is exempted from the registration requirements of the Securities Act as well as from various provisions of the Securities Exchange Act.[27]

Finally, Congress has explicitly provided that securities issued by a mutual or cooperative organization that provides a commodity or service for the benefit of its members are exempt from the registration requirements of Section 12(g) of the Securities Exchange Act, so long as "no dividends are payable to the holder of the security." [28]

as a whole, particularly with respect to massive ventures such as the project in the instant case. Petitioners do not suggest that there is anything inherent in the cooperative housing business which would make registration especially onerous, or interfere to any greater extent than with normal commercial ventures which must register their securities offerings with the Commission.

[27] Section 3(a)(2) of the Securities Act, 15 U.S.C. 77c(a)(2); Section 3(a)(12) of the Securities Exchange Act, 15 U.S.C. 78c(a)(12). A state therefore might be able to remove limited-income housing companies from the necessity of compliance with the registration provisions of the federal securities laws by guaranteeing the securities issued by those companies.

[28] See Section 12(g)(2)(F), 15 U.S.C. 78*l* (g)(2)(F). This provision was enacted to exempt rural electric cooperatives from the registration requirements of Section 12(g). See Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce, on H.R. 6789, H.R. 6793, S. 1642, 88th Cong., 1st and 2d Sess., Part II, 859–860. Since the language of the exemption also covers a venture of the type conducted by a housing cooperative, the exemption may cover cooperatives of

Furthermore, the Commission by rules has recognized that securities issued by certain cooperative housing developments do not necessarily involve the same quality of investment risk as other forms of securities and has accordingly afforded appropriate exemptions. Commission Rule 235, 17 C.F.R. 230.235, for example, exempts the stock of certain cooperative housing corporations from the registration provisions of the Securities Act.[29] The Commission has also ex-

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that character as well. It is uncertain whether Riverbay is entitled to this exemption, however, since, as we have seen, a limited profit housing company may lawfully pay dividends, and the absence of dividends is a condition of the exemption.

In addition to the foregoing categories of exemption, the exemption in Section 3(a)(4) of the Securities Act, 15 U.S.C. 77c(a)(4), to issuers organized and operated exclusively for charitable or benevolent purposes and not for pecuniary profit, might be available to non-profit cooperatives, provided that "no part of the net earnings * * * inures to the benefit of any person, private stockholder, or individual." A similar exemption is available from the registration requirements of Section 12(g) of the Securities Exchange Act, 15 U.S.C. 78*l*(g), in Section 12(g)(2)(D) of the Act, 15 U.S.C. 78*l*(g)(2)(D).

[29] Subject to the limitations imposed upon the Commission by Section 3(b) of the Securities Act, 15 U.S.C. 77c(b), relating to the aggregate size of an offering that the Commission might by rule exempt, the Commission by Rule 235 provided "an exemption for stock or other securities representing membership in a cooperative housing corporation where the securities are issued only in connection with the sale or lease of dwelling units in the housing project and are transferable by the purchaser only in connection with the transfer of such dwelling units" (Securities Act Release No. 4305 (December 8, 1960), 25 Fed. Reg. 12912).

The Commission's release relating to condominiums (Securities Act Release No. 5347 (January 4, 1973), 38 Fed. Reg. 1735), relied upon by petitioners, was a statement to the public and the

empted real estate brokers who sell shares of cooperative housing corporations from registering with the Commission as securities brokers under the Act.[30]

To be sure, the fact that petitioners' enterprise may be exempt from the registration requirements does not thereby exempt it from the antifraud provisions of the securities acts, or exclude its offering from the definition of a "security" in the acts. Exemptions from registration pertain to "certain types of securities and securities transactions where there is no practical need for [registration] or where the public benefits are too remote" [31] either because appropriate state and local authorities already possess adequate information about the enterprise or because the likelihood that invested funds will be misused is relatively low. But the need to protect innocent investors from being misled turns upon different considerations about the quality and amount of information necessary to en-

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real estate industry that offerings of real estate, especially resort real estate, may, under some circumstances, constitute securities. The release was not intended to set forth an all-encompassing standard for real estate of every description, and that release is no way involved under the circumstances of this case.

Nor can the "No Action" letter to which petitioners refer be taken as a statement of general policy. Because such letters represent only the views of the staff, and then only with respect to an enforcement posture in a particular case, they have no precedential value. In any event, the views expressed by the Commission staff do not necessarily reflect the views of the Commision, 17 C.F.R. 202.1(d).

[30] Rule 15a-2, 17 C.F.R. 240.15a-2. See also Securities Exchange Act Release No. 3963 (June 10, 1947), 13 Fed. Reg. 8204.

[31] H. Rep. No. 85, 73d Cong., 1st Sess. 5.

able members of the public to make informed decisions about where they will invest their savings.

Compliance with the antifraud provisions of the securities acts would not, however, disrupt the limited profit cooperative housing industry. To the contrary, it should strengthen it by helping to assure that low income persons who invest their limited savings in cooperative housing enterprises are provided with truthful and complete information concerning the kind of obligations they may incur under their investment contracts and the benefits they may reasonably expect to receive.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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